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CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS
FOR THE YEAR ENDED
JUNE 30, 2009

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**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For the Year Ended June 30, 2009

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MEMORANDUM ON INTERNAL CONTROL

December 3, 2009

To the City Council of
the City of Rancho Cordova, California

In planning and performing our audit of the financial statements of the City of Rancho Cordova as of and for the year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we noted no matters that we consider to be material weaknesses. We noted other deficiencies that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

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**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2009-01 Internal Controls – Segregation of Duties

During our review of the City's internal controls for proper segregation of duties and procedures, we noted areas in which controls need to be improved and employee's access and/or duties revised. Good internal controls require that employees with access to the City's assets not have access to the City's accounting records for the same assets. Inappropriate access could potentially result in undetected errors. While we understand that the City is in the process of reviewing its policies and procedures, the areas we noted that should be addressed first are as follows:

a. Access to Cash Receipts Prior to Bank Deposit

The Customer Service Specialist opens the mail, restrictively endorses all checks received, and provides the checks to the Accountant. The Accountant sorts the checks, codes the developer deposit checks, puts the checks in the safe, and gives copies of the checks that still need to be coded to other staff, depending on the type of remittance. Although rare, there are also occasions in which developers pay in person directly to the Accountant. All of the checks are not deposited into the bank prior to completion of the account coding of the items.

The Accountant is responsible for developer billings, can write-off receivable balances and has access to the general ledger. In addition, the Senior Accounting Technician can void receipts in the business license system and has access to the cash deposit and accounts receivable system. Both employees have access to the safe.

Control over cash collections should be in place from the time of collection until deposit with the bank. And, employees with access to assets should not also have access to the processes associated with those assets. There is the potential risk of undetected errors and incomplete bank deposits.

To improve internal controls, total cash collections should be determined prior to the sorting and dissemination of the copies of the checks to the other accountants, and the bank deposit should be made immediately, without waiting for the coding. The City should consider having the Customer Service Specialist total up the daily cash collections via a 10-key tape or Excel spreadsheet. The daily cash collection summary could then be provided directly to the Senior Accountant for comparison to the actual deposit on the bank statement and for use in preparing the bank reconciliation, and the cash receipts (checks) could be provided to the Senior Accounting Technician for preparation of the daily bank deposit.

In addition, the person that prepares accounts receivable billings should not also be involved with the cash collections related to those billings, and voided receipts should be approved by someone other than employees involved with cash collections. If some of the duties cannot be assigned to another employee, an additional compensating control should be implemented.

**CITY OF RANCHO CORDOVA
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SCHEDULE OF SIGNIFICANT DEFICIENCIES

2009-01 Internal Controls -- Segregation of Duties (Continued)

Management's Response:

While Management concurs that a daily cash receipts log compared to the deposit and traced to the bank statement would provide optimal internal controls, processing the deposit en masse, independent of whether the receipt needs to be recorded in Hansen and/or Great Plains, would result in additional complexities in the accounts receivable process. In this situation the benefit does not exceed the cost. While there is a potential for undetected errors and incomplete bank deposits, Management believes the risks are mitigated as the revenues are monitored by those not involved in the accounts receivable process, such as Finance, City Manager and departmental staff monitoring budget to actual results, project managers monitoring their projects and/or consultants monitoring reported revenues such as UUT. Management also requests receipts to be wired to the City whenever possible, with most receipts from the State and County sent electronically, such as property tax, Gas Tax, MVILF and Sales Tax.

In regards to the Accountant responsible for developer billings, having the ability to write-off receivable balances, adjust the general ledger and receive payments, Management appreciates the auditors finding and acknowledges that a control deficiency exists. Management is currently in the process of creating alternative procedures and controls to correct or mitigate this condition.

b. Ability to Write-off Accounts Receivable, Access to Accounts Receivable Module, and Ability to Adjust the General Ledger

The Finance Director has access to the accounts receivable system module, has the authority to write off accounts receivable, and can adjust the general ledger, however the Finance Director is not involved with the processing of cash collections and accounts receivable.

The Finance Director's access to the accounts receivable module should be removed. If some of the duties cannot be assigned to another employee, an additional compensating control should be implemented.

Management's Response:

The Finance Director's access to the accounts receivable module has been removed.

c. Review of Developer Billings

The Senior Accountant prepares billings to developers on a monthly basis, however the billings are not reviewed by a second person prior to mailing. All customer billings should be reviewed by a second person for accuracy.

Management's Response:

The Senior Accountant will review those billings and will reconcile the billed amount to the developer deposit general ledger account.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2009-01 Internal Controls – Segregation of Duties (Continued)

d. Accounts Payable Processing and Access to the Vendor Database

The Accountant processes project accounts payable and has access to the vendor database and the general ledger. Access to the vendor database should be limited to employees that are not involved with accounts payable processing. If access to the vendor database cannot be removed from the Accountant, the City should determine whether a database edit report can be produced and reviewed by another employee after each accounts payable check run to ensure all revisions and additions were properly authorized.

Management's Response:

Management concurs with the auditor's recommendation. Access to the vendor database has been restricted to an employee that is outside the project accounts payable process.

e. Appropriate System Access to General Ledger System Modules

The Intern had access to adjust the general ledger and had access to the fixed assets, accounts receivable, and accounts payable modules of the system. The Intern's job duties did not include the use of all of these functions. System access should be limited to only the modules required by an employee's job position. We understand that when the Intern was hired, the City was unsure of the access necessary for her job functions and provided her with access to most modules, but the access was not reviewed after her assignments were determined.

Although we understand that the Intern is no longer employed by the City, the City should ensure that access to the general ledger system is appropriate for all employees, regardless of their title. The City should review access for all other employees to ensure it is appropriate.

Management's Response:

Management agrees and access has been removed from the Intern position. Earlier this fiscal year, the City reviewed all employees' access.

f. Review and Approval of Journal Entries

We selected 30 journal entries for testing of review and approval procedures and adequate supporting documentation. We noted one journal entry, which was prepared, reviewed, and posted by the Finance Director. In processing a Journal Entry, no one person should prepare, review, and post an entry. Due to an increase in demand on staff resources and time restraints during the year-end closing process and annual financial statement audit the Finance Director will sometimes post her own journal entries.

The City should ensure that all journal entries are reviewed and approved, regardless of the type of journal entry or the timing of the journal entry posting. This review should be performed by a qualified employee independent of the preparation and posting process.

Management's Response:

Finance Director no longer posts entries. Entries are posted by staff and reviewed by the Finance Director.

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**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2009-02 Cash and Investments – Review, Reporting and Compliance

We reviewed the City's policies and procedures related to cash and investments and noted the following:

a. Investment Manager Agreements

The City had \$18.7 million invested through PFM as of March 31, 2009. While the investments under PFM's management appeared to be in compliance with the requirements of the City's investment policy, the City's investment management agreement with PFM did not require PFM to invest in securities that are in compliance with the City's investment policy or the California Government Code.

The City's investment policy and the California Government Code Section 53601 include specific limitations as to the type of investments that are allowable in the City's portfolio, minimum credit ratings, and maximum maturities. Investment managers must be made aware of these limitations, especially in the event the City's investment policy is more restrictive than the Government Code. Although the City reviews the monthly statements from PFM, without knowledge of the City's specific requirements, the investment manager could invest in an investment that was not in compliance with the City's investment policy or the California Government code.

While we understand that the agreement with PFM was established when the City was newly incorporated and the City had not yet established all required policies, the City should revise its agreement with PFM to require the purchase of investments that are in compliance with the limitations of the City's Investment Policy. In the future, all investment manager agreements should require the same.

Management's Response:

The agreement with PFM was amended in November 2009.

b. Investment Reports

Investment reports are submitted to Council on a quarterly basis, and based on our review of the investment reports for the quarters ending March 31, 2009 and June 30, 2009, we noted that the investment reports include a listing of investments by account, along with the market value, par value, and maturity date of the City's investments.

However, the Reporting Section of the City's investment policy adopted with Resolution #16-2009, requires that "The City Treasurer shall provide a monthly investment report to the City Council," and that the schedules in the monthly report include the following:

- A list of individual securities held at the end of the reporting period by authorized investment category
- Average life and final maturity of all investments
- Earnings rate on an annualized basis
- Market value, par value and amortized book value
- Percentage of the portfolio by investment category

**CITY OF RANCHO CORDOVA
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SCHEDULE OF OTHER MATTERS

2009-02 Cash and Investments – Review, Reporting and Compliance (Continued)

The Performance Section of the investment policy requires that “The City will measure the portfolio’s performance against a market benchmark that is commensurate with the City’s investment risk constraints and the cash flow characteristics of the portfolio.” The March and June investment reports did not include such a benchmark comparison.

The City should either revise the Investment Policy to reflect the procedures in place, or submit the investment report to Council on a monthly basis and revise the report to include the required information, to be in compliance with the Policy.

Management’s Response:

The City will update the investment policy in February 2010 and will amend the Investment Reports to be in compliance with the updated investment policy.

c. Reconciliation of Treasurer’s Report to the General Ledger

The City does not reconcile the quarterly investment report (submitted to City Council) to the general ledger. Since the investment report includes only the par and market value of investments, and the general ledger remains at cost until year-end, staff believes that the reconciliation would be a bit cumbersome. However, fiscal information submitted to City Council should be reconciled to the general ledger to ensure accurate reporting.

The City should reconcile the quarterly (or monthly) investment report to the general ledger to ensure all transactions have been recorded and reported properly, and that that information is reported to Council accurately. If information necessary to facilitate that reconciliation is not included on the investment report, such as the cost of the investments, the City should consider adding the necessary information to the report.

Management’s Response:

The Treasurer’s Report is reconciled to the investment reports and the investment reports are reconciled to the general ledger. To facilitate a direct reconciliation between the report and the general ledger, a cost column was added to the treasurer’s report as of December 2009.

d. Reconciliation of Pooled Investments Held by Fiscal Agent to Pool Investment Statements

The City has pooled investments held by its fiscal agents and receives both the fiscal agent and pooled investment statements, however the statements are not reconciled to one another. Supporting investment statements should be reconciled to the fiscal agent statements on a monthly basis. Although the City does reconcile the monthly fiscal agent statements to the general ledger activity, the City should reconcile the monthly pooled investment statements with the fiscal agent statements to ensure there are no unreconciled differences.

Management’s Response:

The City began reconciling the monthly pooled investment statements with the monthly fiscal agent statements in July 2009.

**CITY OF RANCHO CORDOVA
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SCHEDULE OF OTHER MATTERS

2009-02 Cash and Investments – Review, Reporting and Compliance (Continued)

e. Investment Policy –Internal Controls

Section "Internal Control" of the Investment Policy indicates that "The City Treasurer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures." We have not been requested to perform such an audit, and we do not perform a separate audit or review of investments as part of our audit of the financial statements. We would be happy to perform any procedures the City specifies regarding its investments. Otherwise, these words should be revised or removed from the Investment Policy.

Management's Response:

The City will update the investment policy in February 2010.

f. PFM Statement Reconciliation with Safekeeping Statements

The City uses the investment manager statement from PFM to record all investment activity. While the City receives copies of the associated safekeeping statements, the investment manager statements are not reconciled to the safekeeping statements. The City should reconcile all investment safekeeping statements and investment manager reports to one another and to the general ledger to ensure that all investments are accounted for.

While we understand the market value information on the two statements may not be identical on the two statements due to the entities using different market valuation data, at a minimum, the City should reconcile the investments reported on both statements using the par amount of the investments to ensure there are no differences. Then, the City should compare the market values for the investments (in total) to ensure the differences are not significant. If there are any significant variances, the City should inquire of PFM the potential cause of the difference for specific investments to ensure there is not a problem with the investment(s).

Management's Response:

The City has implemented a reconciliation process between the safekeeping statements and the investment manager reports starting in July 2009.

2009-03 Accounts Payable and Purchasing Procedures – Policy Compliance

We reviewed the City's policies and procedures related to accounts payable and disbursements and noted the following:

a. Use of Purchase Orders

We selected disbursements for testing of controls and compliance with the City's policies and found that in accordance with the administrative policy memo regarding purchasing authority that summarizes the procedures in place at June 30, 2009 (signed by the City Manager and dated July 28, 2009), the City only issues purchase orders for contracted services for the purpose of tracking project expenses. Of the thirty disbursements selected for testing, sixteen of the disbursements were made without the use of a purchase order. Although the disbursements appeared to be properly authorized by applicable personnel, the City's formal Purchasing Policy (Municipal Code Section 3.60.070) requires the use of purchase orders for all purchases.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2009-03 Accounts Payable and Purchasing Procedures – Policy Compliance (Continued)

If the City's formally adopted purchasing policy is inconsistent with City's procedures in place it may become difficult for City staff to ensure proper procedures are being followed when issues arise. The City should either revise the formal Purchasing Policy to reflect procedures in place, or revise the current procedures to be in compliance with the formal Purchasing Policy.

Management's Response:

Management concurs with the auditor's recommendation and is in the process of revising the formal Purchasing Policy to comply with current procedures.

b. Purchasing Policy Bidding Requirements

We selected thirty disbursements for testing of compliance with the City's Purchasing Policy. We noted four disbursements for services contracts that were not awarded using a bid process. Although the contracts were approved by Council, we did not see documentation of the Council approval of the exemption from the required bid process. The City's Purchasing Policy (Municipal Code Section 3.60) indicates that bids are required for contracts in excess of \$20 thousand, subject to certain exemptions in the Policy depending on the type of contract, unless the Council has approved an exemption from the bid requirement.

Again, if the City's formally adopted purchasing policy is inconsistent with City's procedures in place it may become difficult for City staff to ensure proper procedures are being followed when issues arise. The City should either revise the formal Purchasing Policy to reflect procedures in place, or revise the current procedures to be in compliance with the formal Purchasing Policy.

Management's Response:

Management concurs with the auditor's recommendation and is in the process of revising the formal Purchasing Policy to comply with current procedures.

2009-04 Developer Deposits Payable (and Receivable) Accounting and Reconciliation

We selected 5 deposits payable (and receivable) balances as of March 23, 2009 for testing of proper accounting and supporting documentation. During our test work we noted one deposit balance from a developer in the amount of \$26,444 that had actually been refunded to the developer on September 24, 2007.

We also noted that the City only reconciles the activity in the deposits payable sub-ledger to the general ledger on an annual basis. Data reported in the accounting module sub-ledger should be consistent with the data recorded in the general ledger and the two modules should be reconciled on a periodic basis.

The deposit refund was recorded in the general ledger in fiscal year 2008, but the sub-ledger module was not updated to reflect the correction. We also understand that some of the developer deposit balances set up as projects in the sub-ledger module were setup incorrectly which makes the accounting and reconciliation process cumbersome.

The City should review the setup of all the project accounts in the developer deposit accounting module and make any necessary adjustments to correct past errors and to help prevent them in the future. In addition, the sub-ledger should be reconciled to the general ledger at least on a quarterly basis to ensure errors or misstatements do not go undetected and are corrected in a timely manner.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2009-04 Developer Deposits Payable (and Receivable) Accounting and Reconciliation (Continued)

Management's Response:

An error was discovered in the set up for refunds in fiscal year 2009. All of the project set ups were reviewed at that time; however, the refund referred to above was processed in the prior year and had gone undetected. The project has been corrected to reflect the payment of the refund. The City will implement a monthly reconciliation after the monthly billings to ensure that the billed amounts are properly recorded in the developer deposit account. An annual reconciliation to the billed balances will be performed.

2009-05 Updating Interfund Loan Agreements

The City has three interfund loans totaling \$4.9 million from the General Fund to other funds of the City. While the City has established interest terms for the loans, one of the loan agreements has expired without repayment, and one of the advances does have formal repayment terms. GASB Statement 34 requires that repayment of interfund advances must be expected "within a reasonable time". Otherwise, the "advance" should be accounted for as a transfer. The City should review all of its interfund advances to ensure that repayment agreements are current and repayment terms are in place.

Management's Response:

Management concurs with the auditor's recommendation and has reviewed all of the advances. The terms of one advance will be revised when the resolution to spend the money is completed. The other advance will be paid over the next ten years from general impact fees. This is considered to be within a reasonable time to justify the use of the classification "advance".

2009-06 Accounting for the Sequential Use of Journal Entries

The City does not account for the sequential use of journal entries used in the general ledger system to ensure all journal entries are properly authorized. We understand that the City's accounting system assigns a journal entry number for all entries (including system generated entries for accounts payable and payroll batches) in the same sequence, and the volume of entries hinders the ability to account for the sequential entries.

The City should establish a process to review the sequential use of journal entry numbers to ensure that all journal entries are accounted for and properly authorized. If gaps in the journal entry sequence are not accounted for, there is the potential risk that someone could fill in the gaps with inappropriate journal entries without being discovered. If a system-generated report cannot facilitate the review of the sequential numbering of journal entries, it is considered good practice to maintain a sequential log of all non-system generated journal entries.

Management's Response:

This practice is impractical. Other controls are in place to mitigate the risk noted.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2009-07 Internal Service Funds

Three of the City's Internal Service Funds were established prior to July 1, 2007 and two of the Internal Service Funds were established during fiscal year 2009. However, these funds do not report capital assets or charges for services (to other funds/departments), and have not made any expenditures to date. The only activities in each of these funds have been transfers in from the General Fund.

While we understand that the Internal Service Funds are "young" and are just beginning to accumulate funds for the future purpose of each fund (insurance, replacement, capital facilities and infrastructure), the City should review each of the funds to determine if any applicable activity recorded in other City funds should instead be reported in the Internal Service Funds. For example, the Insurance Fund should be used to pay for the insurance costs of the City and those costs should then be charged to the applicable departments / funds. This activity should be reported as revenue to the Internal Service Fund and as expenditures in the applicable departments/funds. In addition, for the Replacement, Capital Facility and Infrastructure Funds, the City should determine if any of its existing capital assets should be transferred to these funds to start accumulating funds for the future replacement of those assets.

Management's Response:

Management is considering the auditor's recommendation and will be reviewing the activity in other City funds to determine if any should be reported in the Internal Service Funds.

2009-08 SAS 70 Report Review for Service Providers

The City has third party fiscal agents (Wells Fargo and U. S. Bank) that manage the investment of bond proceeds, and banks that perform investment safekeeping for the City's pooled investments (BNY and Wells Fargo). The procedures used by these service organizations are outside the scope of City oversight and staff review, and these controls are not part of the scope of an audit of the City's financial statements. Typically cities employ a variety of approaches to gain comfort that service organizations are performing their functions in a prudent manner and producing reliable data. For example, fiscal agents manage funds held pursuant to debt indentures, but cities rarely have audits performed as City staff review transactions and verify the trust data. Less frequently, special audits are performed to determine the adequacy of controls and to verify the data produced. There is a third option which is to request a copy of the entity's review and report on internal controls pursuant to the requirements of SAS 70.

Statement on Auditing Standards #70—Service Organizations (SAS 70) establishes auditing standards to be followed to ensure that any service organization's systems and controls are adequately designed and are operating effectively. SAS 70 has two parts. Part one is designed to review controls over the service provided at a particular date and to report on whether the design of these controls appear to be adequate on that date. Part two is designed to test these controls over a six month period and to report on whether the design of the controls appears adequate and whether the auditor can reasonably conclude that the controls were operating effectively.

SAS 70 audits may reveal weaknesses in the internal controls of service organization that may otherwise go undetected by the City, and may impact the City's transactions.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2009-08 SAS 70 Report Review for Service Providers (Continued)

There does not appear to be a formal requirement for service providers to obtain a SAS 70 audit, however the City should request a copy of the SAS 70 reports from its service providers on an annual basis. It would be preferable if the contractor had both parts of a SAS 70 audit performed and the report be furnished directly to the City for review. Any weaknesses or system problems disclosed by that audit should be addressed and resolved by the contractor to the satisfaction of the City. If the entity does not have a SAS 70 audit, the City should determine whether further follow up is necessary or if the City's review processes of transactions processed by the entity are sufficient.

Management's Response:

The City will obtain SAS 70 reports from their service providers.

2009-09 Information Technology Best Practices Recommendations

We conducted an Information Systems Review with our audit which encompassed the City's financial information system and the network environment that houses it. Our work goes beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards to which local governments are required to conform. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses we noted a few areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are "best practices" as follows:

Payment Card Industry Compliance

The City is not compliance with the Payment Card Industry Data Security Standard (PCI-DSS). Any organization that processes credit cards is required to comply with PCI-DSS, even if the processing is outsourced. Failure to meet compliance results in higher transaction fees and liability if a security breach is found. Because the City accepts credit cards as a form of payment, the City must be compliant with the applicable controls.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

2009-09 Information Technology Best Practices Recommendations (Continued)

Audit/Event Logging

The City does not appear to have audit logs on the financial application server, such that any change, addition or deletion of user accounts within the application are tracked and monitored. The City should have audit/event logs of any addition, deletion or change in financial application user accounts and that log should be monitored by someone without the rights to effect such changes. In addition, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.

General Information Systems Controls – We reviewed the compliance of the City's information systems with the National Institute of Standards and Technology (NIST) information security standards based on a moderate risk system. We noted a number of controls that did not appear to be in place. A separate report of those controls was provided to the City's IT and Finance personnel. We recommend the City choose an appropriate industry standard like NIST to help plan, organize and review information security.

Management's Response:

Management will review the standards recommended by the auditor. An audit trail module for Great Plains is also being investigated. A cost-benefit analysis will be performed to determine the best practices to be implemented.

**CITY OF RANCHO CORDOVA
MEMORANDUM ON INTERNAL CONTROL**

SCHEDULE OF OTHER MATTERS

NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD PRONOUNCEMENT:

The following comment represents a new pronouncement taking affect in the next few years. We cite it here to keep you abreast of developments:

2009-10 GASB Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions (Effective for fiscal 10/11)

This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The initial distinction that is made in reporting fund balance information is identifying amounts that are considered **nonspendable**, such as fund balance associated with inventories. This Statement also provides for additional classification as **restricted, committed, assigned, and unassigned** based on the relative strength of the constraints that control how specific amounts can be spent.

The **restricted** fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

The **committed** fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority.

Amounts in the **assigned** fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds *other than the general fund*, assigned fund balance represents the remaining amount that is not restricted or committed.

Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. *In other funds*, the unassigned classification should be *used only to report a deficit balance* resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The Statement also clarifies the governmental fund definitions. The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

Management's Response:

The City will prepare for the implementation of the provisions of the Statement in fiscal year 2011.

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REQUIRED COMMUNICATIONS

December 3, 2009

To the City Council of
the City of Rancho Cordova, California

We have audited the financial statements of the City of Rancho Cordova as of and for the year ended June 30, 2009 and have issued our report thereon dated December 3, 2009. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2009. As described in notes to the financial statements, during the year, the City implemented the following new standards:

GASB Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations – This Statement establishes financial reporting of obligations for pollution remediation. There was no material effect on the financial statements from the implementation of this statement.

GASB Statement No. 50 Pension Disclosures — an amendment of GASB Statements No. 25 and No. 27 – This Statement amends prior year disclosures for cost sharing defined benefit pension plans by requiring among other things, funding trend data for cost sharing pools. Minor modifications were made to Note 10 to the financial statements to incorporate the requirements of the Statement.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2009.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are the fair value of investments, depreciation, and compensated absences.

Estimated Fair Value of Investments: As of June 30, 2009, the City held approximately \$112.8 million of cash and investments as measured by fair value as disclosed in Note 3 to the Financial Statements. Fair value is essentially market pricing in effect as of June 30, 2009. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2009.

Estimate of Depreciation: Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 6 to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimate of Compensated Absences: Accrued compensated absences which are comprised of accrued vacation and sick leave is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year as disclosed in Note 1F to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no difficulties in dealing with management relating to the performance of the audit.

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us but not recorded by the City that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the Council.

This report is intended solely for the information and use of the audit committee, City Council, and management and is not intended to be and should not be used by anyone other than these specified parties.

Mane & Associates

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